

Message Text

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PAGE 01 ROME 18496 01 OF 02 190410Z

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AMCONSUL MILAN
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LIMITED OFFICIAL USE SECTION 1 OF 2 ROME 18496

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TAGS: EFIN, IT
SUBJECT: VIEWS OF MILANESE BANKERS ON ITALIAN ECONOMIC
SITUATION

REF: ROME 8984

SUMMARY. DURING VISIT TO MILAN DECEMBER 15-17, TREASATT
ELICITED FOLLOWING VIEWS FROM MILANESE BANKERS: 1) INITIAL
SIGNS OF ECONOMIC RECOVERY MAINLY REFLECT REBUILDING OF INVEN-
TORIES. SMALL AND MEDIUM BUSINESSES ARE SURVIVING RECESSION
BETTER THAN LARGE BUSINESSES. PROSPECTS FOR RECOVERY OF IN-
VESTMENT BOTH IN SHORT TERM AND OVER MEDIUM TERM ARE GENERALLY
VIEWED PESSIMISTICALLY. 2) HIGH DEBT/EQUITY RATIOS OF ITAL-
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PAGE 02 ROME 18496 01 OF 02 190410Z

IAN BUSINESSES ARE FINANCIALLY UNDESIRABLE, BUT MORE BASIC

PROBLEM IS LACK OF PROFITABILITY DUE TO HIGH LABOR COSTS.

3) SINCE ECONOMIC RECOVERY IN 1976 WILL PROBABLY BE VERY MODERATE, BALANCE OF PAYMENTS DEFICIT, TOO, SHOULD BE FAIRLY SMALL. 4) CONTINUED GREAT POLITICAL UNCERTAINTY IS MAINLY HAVING ADVERSE EFFECT ON INVESTMENT DECISIONS, ALTHOUGH SOME HEAD OFFICES OF FOREIGN BANKS ARE CONCERNED ABOUT "COMMUNIST" TAKEOVER." 5) ITALY'S FOREIGN CREDITWORTHINESS HAS IMPROVED SLIGHTLY, AT LEAST WITH REGARD TO SHORTER-TERM CREDITS, AND THERE MAY BE SOME PROSPECT IN 1976 FOR MODERATE AMOUNT OF TERM LOANS. END SUMMARY.

1. ECONOMIC RECOVERY. BANKERS ALL AGREED THAT ECONOMY HAS ALREADY TOUCHED BOTTOM AND THAT THERE WERE SOME MODEST SIGNS OF ECONOMIC RECOVERY, BEGINNING AROUND OCTOBER. HOWEVER, POSITIVE SIGNS WERE MAINLY DUE TO SOME RE-BUILDING OF INVENTORIES, AND RATHER MODEST INCREASES IN SALES OF REPLACEABLE CONSUMER DURABLES, INCLUDING AUTOS. TO SOME EXTENT, SIGNS OF RECOVERY MAY BE DUE TO SEASONAL FACTORS. FIRST QUARTER 1976 WILL PROBABLY BE SEASONALLY WEAK AND COULD SUFFER FROM STRIKE ACTIVITY ASSOCIATED WITH CURRENT WIDESPREAD LABOR CONTRACT NEGOTIATIONS. MOST PEOPLE THOUGHT THAT RECOVERY WOULD REALLY NOT GET UNDERWAY UNTIL LAST HALF 1976, ALTHOUGH ONE OR TWO THOUGHT THAT RECOVERY MIGHT COME SOMEWHAT SOONER. THERE WAS GENERAL BELIEF THAT MEDIUM AND SMALL INDUSTRY HAS SURVIVED RECESSION RELATIVELY BETTER THAN LARGE INDUSTRY. THIS WAS BECAUSE MEDIUM AND SMALL BUSINESSES WERE BETTER ABLE TO EVADE TAXES AND, TO SOME EXTENT, SOCIAL INSURANCE CHARGES. AT SAME TIME CYCLICAL INCREASE IN BANK LIQUIDITY HAS RELIEVED CHRONIC PROBLEM OF INSUFFICIENT CREDIT FOR THESE BUSINESSES. NOTWITHSTANDING RELATIVELY FAVORABLE POSITION OF MEDIUM AND SMALL INDUSTRY, THERE WAS WIDE BELIEF THAT FUTURE INVESTMENT PROSPECTS IN THIS SECTOR WERE VERY POOR, BECAUSE OF POLITICAL AND ECONOMIC (ESPECIALLY LABOR COST) PROBLEMS. ONE US BANKER SAW SIGNS OF SOME ITALIAN OWNERS OF SMALL AND MEDIUM BUSINESSES SELLING OUT THEIR ITALIAN HOLDINGS IN POSSIBLE PREPARATION FOR COMMUNIST TAKEOVER, BUT THIS PHENOMENON DID NOT SEEM WIDESPREAD. ANOTHER BANKER SUGGESTED THAT SLOW ECONOMIC RECOVERY WOULD REALLY BE BETTER THAN FAST RECOVERY, SINCE IT WOULD LIMIT RISK OF ACCELERATED INFLATION AND BALANCE OF PAYMENTS DEFICITS, WHILE MAINTAINING SOME CONTINUING LIMITED OFFICIAL USE

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PAGE 03 ROME 18496 01 OF 02 190410Z

PRESSURE ON LABOR UNIONS TO MODERATE THEIR DEMANDS. ONE BANKER THOUGHT THAT BOTTLENECKS COULD OCCUR RATHER QUICKLY WHEN RECOVERY GETS UNDERWAY, BOTH IN FORM OF INADEQUATE PRODUCTIVE CAPACITY, BECAUSE OF OBSOLESCENCE OF EQUIPMENT, AND IN FORM OF SCARCITY OF SKILLED LABOR. LATTER WAS DUE TO FACT THAT MANY WORKERS NOW ON SHORT TIME WORK HAVE SECOND JOB, SO THAT WHEN THEY ARE RECALLED TO WORK IN PRIMARY JOB, ABSENTEEISM WILL ONCE AGAIN RISE, AS THEY ATTEMPT TO MAINTAIN SECON-

DARY JOB AS WELL.

2. INDUSTRIAL RECONSTRUCTION. TREASATT ASKED BANKERS OPINION ABOUT GOI PROPOSALS FOR RECONSTRUCTION OF ITALIAN INDUSTRY, INCLUDING EFFORT TO INCREASE RISK CAPITAL VS. DEBT CAPITAL AS SOURCE OF INVESTMENT FINANCING. BANKERS WERE UNANIMOUS IN ARGUING THAT REAL FINANCIAL PROBLEM OF ITALIAN BUSINESSES WAS NOT HIGH DEBT EQUITY RATIO BUT LACK OF PROFITABILITY BECAUSE OF HIGH LABOR COSTS. UNTIL THERE WAS CORRECTION IN THIS DISEQUILIBRIUM, NO EFFORTS TO IMPROVE EQUITY CAPITAL MARKET WOULD WORK. HEAD OF ONE ROME SPECIAL CREDIT INSTITUTE TOLD TREASATT EARLIER THAT PROPOSED INDUSTRIAL RECONVERSION FUND WAS REALLY A HIDDEN MEANS OF SUBSIDIZING BUSINESS THROUGH LOW-INTEREST LOANS DESIGNED TO OFFSET HIGH LABOR COSTS IN POLITICALLY ACCEPTABLE WAY, SINCE GOI HAD BEEN UNABLE TO REDUCE RATE OF INCREASE IN SUCH COSTS. ONE BANKER POINTED OUT THAT HIGH DEBT/EQUITY RATIO REFLECTS PAST GOI POLICIES WHICH HAVE FAVORED DEVELOPMENT OF BOND MARKET, PARTLY TO ASSIST PLACEMENT OF PUBLIC DEBT. ALSO, CREATION OF WIDE ARRAY OF SUBSIDIZED INTEREST RATES ON BANK LOANS TO STIMULATE SOUTHER DEVELOPMENT AND FOR OTHER PURPOSES HAS ALSO LED TO WIDESPREAD RESORT TO DEBT FINANCING. ONE US BANKER MENTIONED THAT BANK OF ITALY HAS RECENTLY BEEN ENCOURAGING COMMERCIAL BANKS TO MAKE USE OF LIMITED AUTHORITY WHICH THEY HAVE TO EXTEND MEDIUM-TERM CREDITS, IN ORDER TO LENGTHEN MATURITY SCHEDULES OF BUSINESS DEBT. OFFICIAL OF ONE SPECIAL CREDIT INSTITUTE SAID THAT HE WAS NOT ENTHUSIASTIC ABOUT RECENT PROPOSALS FOR THESE INSTITUTES TO BUY SHARES OF ITALIAN BUSINESSES, EVEN IF SHARES WERE LATER RESOLD TO PRIVATE INVESTORS. (THIS IDEA HAS BEEN SUGGESTED BY MINTREAS COLOMBO AND COULD BE EMBODIED IN DRAFT INDUSTRIAL RECONSTRUCTION DECREE SCHEDULED TO BE APPROVED BY CABINET ON DECEMBER 22.) SOME BANKERS ALSO THOUGHT THAT HIGH DEBT/EQUITY RATIO WAS OF ONLY MODEST LIMITED OFFICIAL USE

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PAGE 04 ROME 18496 01 OF 02 190410Z

IMPORTANCE, SINCE ALL STATE-OWNED COMPANIES AND MANY LARGE PRIVATE COMPANIES WOULD NEVER BE ALLOWED TO FAIL BY GOI BECAUSE OF EFFECT ON UNEMPLOYMENT.

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PAGE 01 ROME 18496 02 OF 02 181638Z

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LIMITED OFFICIAL USE SECTION 2 OF 2 ROME 18496

3. BALANCE OF PAYMENTS. BECAUSE OF GENERAL BELIEF THAT ECONOMIC RECOVERY IN 1976 WOULD BE SLOW, THERE WAS NOT MUCH CONCERN ABOUT BALANCE OF PAYMENTS PROBLEM THAT YEAR. HOWEVER, PROSPECTS FOR 1977 SEEMED MORE UNCERTAIN, IF RECOVERY BEGAN TO ACCELERATE LATE IN 1976 AND IN 1977. MOST BANKERS TENDED TO FOCUS ATTENTION ON PRESUMED INCREASE IN IMPORTS WHICH WOULD ACCOMPANY RECOVERY, BUT THEY DID ACKNOWLEDGE THAT EXPORT RECOVERY MIGHT OCCUR EARLIER IN ITALY'S MAJOR EXPORT MARKETS SO AS TO HELP OFFSET IMPORT GROWTH. ONE BANKER EXPLAINED THAT SOME OF VERY LARGE FOREIGN CONSTRUCTION CONTRACTS WHICH ITALY HAS OBTAINED IN 1975 CALL FOR ADVANCE PAYMENTS OF AS MUCH AS 40 PERCENT OF TOTAL, SO THAT THESE RECEIPTS MAY ALSO HELP TO OFFSET ANY INCREASE IN IMPORTS. BANKERS GENERALLY DID NOT BELIEVE THAT THERE HAD BEEN ANY LIMITED OFFICIAL USE

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PAGE 02 ROME 18496 02 OF 02 181638Z

GREAT INCREASE IN CAPITAL FLIGHT DURING 1975, APPARENTLY BECAUSE NOMINAL INTEREST RATES IN ITALY HAVE REMAINED FAIRLY HIGH COMPARED TO FOREIGN RATES, BECAUSE THERE WAS "NO MORE MONEY LEFT TO EXPORT," AND BECAUSE SMALL AND MEDIUM INDUSTRY WERE DOING FAIRLY WELL AND HAS AN INCENTIVE TO KEEP THEIR FUNDS AT HOME. REFERENCE WAS ALSO MADE TO ITALY'S "HIDDEN

RESERVES" IN SWITZERLAND (I.E., ACCUMULATED CAPITAL FLIGHT) WHICH BOI HAS TRADITIONALLY BEEN ABLE TO DRAW UPON IN PERIODS OF CRISIS BY IMPOSING TIGHT DOMESTIC CREDIT POLICY. THERE WAS GENERAL ASSUMPTION THAT LIRA WOULD APPRECIATE AGAINST DOLLAR IN 1976. ONE KNOWLEDGEABLE BANKER THOUGHT THAT 1976 RATE MIGHT BE ABOUT 705. ANOTHER BANKER FORESAW RATE OF ABOUT 760 FOR 1977.

4. POLITICAL SITUATION. BANKERS WERE NOT AS OBSESSED WITH POLITICAL SITUATION AS DURING LAST VISIT OF TREASATT IMMEDIATELY AFTER JUNE ELECTIONS (SEE REFTTEL). FOREIGN BANKERS IN MILAN WERE PERHAPS MORE CONCERNED WITH EFFECTS ON ECONOMY OF POLITICAL UNCERTAINTIES THAN THEIR BOSSES IN US, WHO SIMPLY FEARED "COMMUNIST TAKEOVER." POLITICAL CONSIDERATIONS WERE MAJOR UNDERLYING EXPLANATION BEHIND PESSIMISM ABOUT FUTURE INVESTMENT PROSPECTS. ONE ITALIAN HEAD OF AMERICAN BANK WAS FAIRLY OPTIMISTIC THAT CHRISTIAN DEMOCRATIC PARTY (DC) WOULD SHOW SOME EVIDENCE OF REFORM BY SPRING 1976. VICE PRESIDENT OF LARGE ITALIAN BANK DESCRIBED SOCIALISTS (PSI) AS REAL ANTAGONISTS OF COMMUNISTS (PCI). HEAD OF ANOTHER LARGE ITALIAN BANK (WHO IS CONSERVATIVE DC MEMBER) COULD SEE NOTHING BUT BAD THINGS AHEAD, BOTH ECONOMICALLY AND POLITICALLY, SINCE PRESENT GOVERNMENT WAS "PLAYING THE GAME" OF PCI.

5. FOREIGN CREDITWORTHINESS. IT WAS CLEAR THAT CONTINUED ASSIGNMENT OF ITALIAN BORROWERS TO "SPECIAL MENTION" CATEGORY OF RISKS BY TREASURY'S COMPTROLLER OF THE CURRENCY IS TAKEN VERY SERIOUSLY BY AMERICAN BANKS' HOME OFFICES. ONE BANKER DESCRIBED THIS AS LIKE "GOD SPEAKING TO MOSES FROM BURNING BUSH." MEVERTHELESS, LARGER BANKS WERE AT LEAST SOMEWHAT MORE INCLINED THAN IN JUNE TO TAKE MORE OPTIMISTIC VIEW OF ITALIAN CREDITWORTHINESS, PARTICULARLY WITH REGARD TO SHORT-TERM CREDITS. ONE AMERICAN BANKER THOUGHT THAT US BANKS SHOULD TAKE LONG VIEW AND BEHAVE ANTI-CYCLICALLY, I.E., BY PROVIDING FOREIGN CREDIT DURING PERIODS OF SOME DIFFICULTY. NOT ONLY WOULD THEY LIMITED OFFICIAL USE

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PAGE 03 ROME 18496 02 OF 02 181638Z

PROFIT FINANCIALLY BY DOING SO, BUT THEY WOULD ALSO MAKE GOOD IMPRESSION WITH ITALIAN GOVERNMENT AND CENTRAL BANK AUTHORITIES. ANOTHER US BANKER THOUGHT THAT PROSPECT OF OBTAINING SEVERAL HUNDRED MILLION DOLLARS IN TERM LOANS DURING 1976 WERE FAIRLY GOOD. WHILE HIS BANK WAS NOT ACTIVELY SEEKING TO GRANT SUCH LOANS, IT WOULD SERIOUSLY CONSIDER ANY LOAN REQUEST PROPOSAL BY BOI. (HE MENTIONED THAT TWO LOAN PROPOSALS FOR \$150 MILLION EACH WERE STILL BEING ACTIVELY EXPLORED, I.E., ONE FOR STATE RAILROADS AND ONE FOR IMI, ALTHOUGH LATTER SEEMED MAINLY TO BE "TESTING THE WATER.") VOLPE

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